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MARKET OUTLOOK REPORT

Volume 2 Number 5

CANADA CANOLA SECTOR PROFILE
PART ONE: SITUATION AND OUTLOOK

November 26, 2010

Market Analysis Group
Grains and Oilseeds Division
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Canada

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CANADA CANOLA SECTOR PROFILE
PART ONE: SITUATION AND OUTLOOK

For 2010-2011, world production of canola/rapeseed is forecast to decrease slightly due to lower output in Canada, China and the European Union (EU-27). In Canada, supplies of canola are forecast to decrease while domestic processors embark on a record setting crush pace as expanded capacity comes on stream. Canadian exports of canola are forecast to decline by almost 16% this crop year as tight domestic supplies limit the industry's ability to capitalize on strong world demand. Canola prices are forecast to average about 10% above 2009-2010, supported by higher United States (US) soybean and soyoil prices, strong Chinese demand for vegetable oils, and strong demand for biofuels in the EU-27. This issue of the Market Outlook Report examines the situation and outlook for canola/rapeseed.

SITUATION

World Oilseed Situation

For 2010-2011, world production of the seven major oilseeds is forecast to decline marginally to 441 million tonnes (Mt), due largely to decreased soybean production. Supplies of oilseeds are forecast to rise to 513 Mt as a result of significantly higher carry-in stocks. Trade and crush for the major oilseeds are forecast to reach record levels of 109 Mt and 373 Mt respectively. Consequently, carry-out stocks are forecast to be marginally lower at 71 Mt.

World Canola/Rapeseed Situation

World canola/rapeseed production for 2010-2011 is forecast to decrease by 5% to 57 Mt, representing about 13% of world oilseed production. This decrease is due to lower production in Canada, the EU-27 and China. As a result of lower carry-in stocks and the decline in output, supply is estimated to be lower than 2009-2010 but will remain higher than normal. Prices are expected to rise from the lows set in 2009-2010 due to increased consumption in the EU-27. World trade and crush are forecast to decline due to reduced supplies, despite strong food demand in North America and Asia combined with strong biofuel demand in the EU-27.

World trade in canola/rapeseed is forecast to decrease by about 9% from 2009-2010, to 9.9 Mt, due to lower supply. The major exporters of canola are Canada, Australia and Ukraine while the major importers are Japan, China, the EU-27, Mexico, the US and Pakistan.

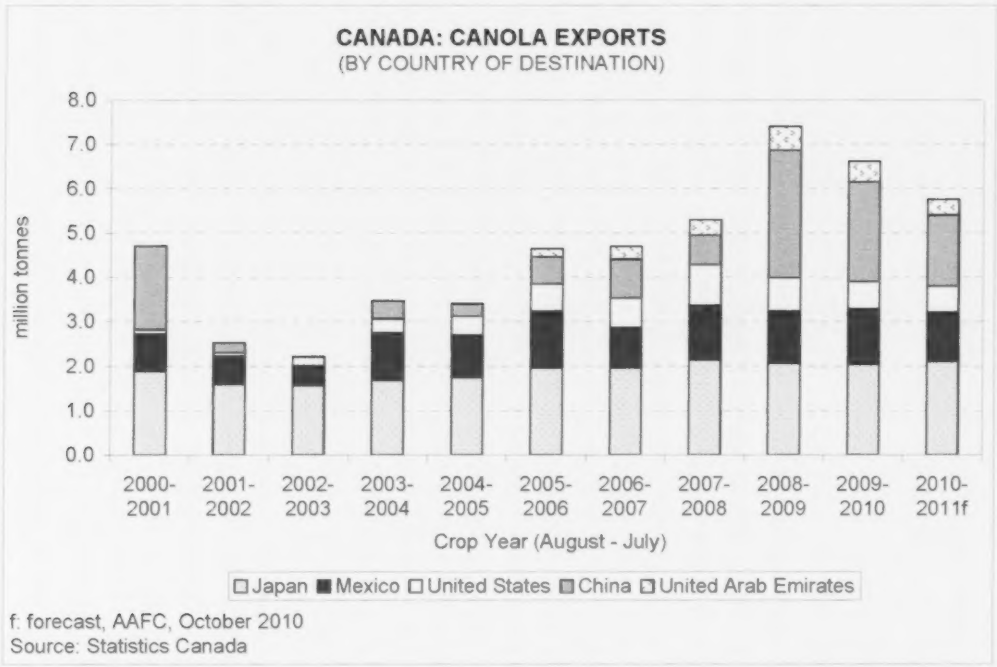
MAJOR EXPORTERS

Canada: Record Crush Forecast for 2010-2011.

For Canada, 2010-2011 was a challenging crop year as an almost ideal early start to seeding was nearly ruined by unusual weather. As a result of the abnormally cool spring and excessive moisture, farmers were unable to seed all of their intended area to canola or had to rip it up due to flooding. This ripped up land ended up as summerfallow.

Despite these seeding problems, farmers managed to set a new seeded area record for canola, an increase of 3% from the previous year. However, harvested area for canola in Canada rose at a slower pace as torrential rains across eastern Saskatchewan and western Manitoba during May and early June, washed out many previously seeded fields. With the worst of the rains falling across the key canola growing region, abandonment, the difference between seeded and harvested areas, increased to 0.44 Mha, or 6% of the planted area versus the long run average of 3%.

For 2010-2011, yields were slightly above the 10 year average but were highly variable as crops outside of the flooded regions benefited from the



f: forecast, AAFC, October 2010
Source: Statistics Canada

moisture. As well, canola crops that survived the flooding matured quickly under the heat stress during the latter part of June and through July.

Production for 2010-11 is estimated to have fallen by about one-sixth while supplies of canola are forecast to fall by only 10% on support from higher carry-in stocks. The domestic crush is forecast to rise to a record 5.5 Mt as recently constructed crush facilities became operational. These crush facilities are located near the Manitoba Saskatchewan border in the middle of the flooded out region.

Canadian exports of canola are forecast to decline by almost 16% this crop year as tight domestic supplies limits the industry's ability to capitalize on strong world demand. Exports to some of the more price sensitive countries are expected to be scaled back while shipments to more service oriented countries are expected to remain near normal levels.

The major international markets for Canadian canola are Japan, China, Mexico and the US. For 2010-2011, Japanese imports of canola from Canada are forecast to remain stable at 2.1 Mt while Mexican imports decline slightly to 1.1 Mt due to constrained Canadian supplies. Chinese imports are forecast to be well short of the 2.9 Mt imported in 2008-2009, partly due to Chinese import restrictions. US imports of canola are forecast unchanged at about 0.6 Mt while shipments to the United Arab Emirates are forecast to decline slightly in response to lower Canadian supplies and steady EU-27 demand for canola oil.

Australia: Timely Rains Helped Crop

For 2010-2011, Australia's canola production is estimated to be one of the largest on record at 2.2 Mt, up from the 1.9 Mt in 2009-2010 mainly due to a 16 % rise in seeded area to 1.6 million hectares (Mha). Seasonal conditions have improved in Australia with beneficial rainfall received during June and July across most of the key growing States. With supply expected to rise, exports are forecast at 1.2 Mt, up from 1.1 Mt in 2009-2010.and sharply higher than the 0.5 Mt shipped out of the country in 2007-08. Key destinations for Australia's canola are expected to be the EU-27 and various Asian and Middle East countries such as Japan, China, Pakistan and the United Arab Emirates.

Australia has conducted a number of trials for Juncea canola varieties for inclusion in crop rotations in lower rainfall locations; however, further breeding work is required to improve yields. Similarly, Australia has investigated the contracted production of specialty oil canola varieties to service niche markets. Unfortunately, independent information is limited on the performance of the new specialty oil canola varieties.

Russia, Ukraine And Belarus: Affected By Drought

For 2010-2011, Russian production of rapeseed is forecast to rise to almost 0.9 Mt although yields may be pressured by the extremely hot and dry weather affecting the Central and Volga districts. Domestic crush is forecast to rise to 0.7 Mt while exports increase slightly to 0.13 Mt with most of the seed destined for the EU-27. Ukrainian rapeseed production is expected to fall short of the early forecasts for a slight rise in output hot and dry weather pressured yields. Production is tentatively forecast at 1.6 Mt, of which about 1.5 Mt will be shipped into the EU. Belarus rapeseed production is forecast at about 0.5 Mt, down from the record 2009-2010 output of 0.6 Mt and well short of earlier estimates as yields evaporated under the adverse growing conditions affecting most of continental Europe. Exports are forecast to fall sharply to about 60 thousand tonnes as a result of lower supplies and the imposition of an export tax. Domestic crush is forecast to fall by almost one-fifth to about 0.4 Mt which will rise that country's imports requirements for oilseeds and products.

CANADA: CANOLA AND PRODUCTS SUPPLY AND DISPOSITION

	2008 -2009	2009 -2010	2010 -2011f
	thousand tonnes		
CANOLA			
Carry-In Stocks	1,461	1,661	2,123
Production	12,643	12,417	10,430
Imports	121	128	250
Total Supply	**14,225**	**14,206**	**12,803**
Exports	7,908	7,127	6,000
Crush	4,280	4,788	5,500
Other Use	377	168	303
Total Use	**4,657**	**12,083**	**11,803**
Carry-Out Stocks	1,661	2,123	1,000
CANOLA OIL			
Carry-In Stocks	50	50	50
Production	1,839	2,107	2,365
Imports	103	180	150
Total Supply	**1,992**	**2,337**	**2,565**
Exports	1,570	1,907	2,125
Domestic Use	372	380	390
Total Use	**1,942**	**2,287**	**2,515**
Carry-Out Stocks	50	50	50
CANOLA MEAL			
Carry-In Stocks	35	35	35
Production	2,487	2,683	3,300
Imports	5	5	5
Total Supply	**2,527**	**2,723**	**3,340**
Exports	1,861	1,750	2,505
Domestic Use	631	938	800
Total Use	**2,492**	**2,688**	**3,305**
Carry-Out Stocks	35	35	35

f: forecast, AAFC, October 2010
Source: Statistics Canada

MAJOR IMPORTERS

Japan: Imports To Remain Steady

For 2010-2011, Japan will be the world's second largest importer of canola and remains a significant and valued market for Canadian canola. Canada has been exporting canola to Japan for nearly half a century and exports have currently stabilized at around 2.0 Mt to 2.1 Mt yearly. From 2005-2006 to 2008-2009, Japan, on average, has purchased one third of the canola exported from Canada. For 2008-2009 and 2009-2010, Japan imported approximately 1 billion dollars of canola yearly.

China: Imports Of Rapeseed Oil To Rise

In response to the rapid rise in domestic demand and its strategic goal to increase investment and employment, China has become the world's largest importer of oilseeds. While accurate data is difficult to obtain, it is estimated that 100 to 150 million Chinese people have moved from rural areas to cities within the past decade. The increasing urbanization of China is supporting a demand for labour saving foods serviced by a growing retail and food processing sector. Simultaneously, China strategically increased the size of its domestic, industrial-scale, crush capacity for oilseeds, to about 88 Mt for 2010-11, compared to an estimated 65 Mt for 2005-06.

This growth in domestic crush capacity is supported by the rising demand for protein meal from the rapidly developing animal and aquaculture sectors. Other important factors supporting the growth in domestic processing are the consolidation of the livestock and aquaculture sectors and the increased protein meal usage by livestock producers of all sizes.

Consequently, Chinese imports of oilseeds have increased by about 90%, from 30 Mt in 2006-2007, to 57 Mt for 2010-2011.

For 2010-2011, China has announced a policy goal of supporting grain production of above 500 Mt and per capita income growth for rural residents at 6%. In support of this goal, the government of China continues to support domestic oilseed production for 2010-2011 through a variety of subsidies and technical support to farmers. The government of China is also expected to continue purchasing domestic soybeans at a floor price despite high carry-in stocks purchased for grain reserves. One of the most heated debates within China is whether the current soybean subsidy and state purchase programs are sustainable in the long run. Unlike other grains, domestic oilseeds retain a small market share and are linked to the world price. This linkage to international prices suggests that China may need to consider domestic support policies for soybeans and other oilseeds different from those used for grain.

The majority of rapeseed in China is crushed for oil and the meal is used domestically in households and as feed for livestock and aquaculture. Rapeseed oil is the third most consumed vegetable oil in China, after soyoil and palm oil, accounting for about 20% of the market.

For 2010-2011, China's rapeseed production is estimated to decrease to 12.8 Mt, from 13.7 Mt in 2009-2010 due to lower yields. Demand for rapeoil in China is expected to exceed domestic supply in 2010-2011 and is expected to import 0.6 Mt of rapeoil.
Canola/rapeseed imports are forecast to decline to about 2.0 Mt, down 0.9 Mt from 2009-2010 and only 41% of the volume imported in 2008-2009 when domestic support policy in China encourage imports. Canada is expected to remain the main supplier. Chinese imports of rapeseed meal are forecast to decline to about 0.6 Mt for 2010-2011

WORLD: CANOLA/RAPESEED AND PRODUCTS SUPPLY AND DISPOSITION

	2008 -2009	2009 -2010	2010 -2011f
	million tonnes		
CANOLA/RAPESEED			
Carry-in Stocks	3.7	6.8	7.5
Production			
European Union	19.0	21.4	20.0
China	12.1	13.7	12.8
Canada	12.6	12.4	10.4
India	6.7	6.4	7.0
Other	7.4	6.6	6.4
Total Production	57.8	60.5	57.2
Total Supply	**61.5**	**67.3**	**64.7**
Domestic Consumption	**54.8**	**59.3**	**59.3**
Carry-out Stocks	6.8	7.5	5.5
Trade	12.0	10.8	9.9
CANOLA/RAPESEED OIL			
Carry-in Stocks	0.4	0.9	1.2
Production	20.5	22.3	22.2
Total Supply	**20.9**	**23.2**	**23.4**
Total Use	**20.0**	**22.0**	**22.4**
Carry-Out Stocks	0.9	1.2	1.0
Trade	2.4	2.7	2.7
CANOLA/RAPESEED MEAL			
Carry-in Stocks	0.2	0.2	0.3
Production	30.8	33.6	33.5
Total Supply	**31.0**	**33.8**	**33.8**
Total Use	**30.8**	**33.5**	**33.5**
Carry-Out Stocks	0.2	0.3	0.3
Trade	3.5	3.4	3.8

f: forecast, USDA, October 2010
Source: USDA

EU-27: Crush To Increase Slightly

Under continued strong and growing demand for vegetable oils, to support the expanding biofuel sector, EU producers are forecast to harvest a record 6.7 Mha of rapeseed for 2010-2011, up 4% from 2009-2010. The increase in rapeseed area was largest in Romania, Bulgaria, Poland and the UK. In Germany, the increase in area was limited by crop rotations as rapeseed should not be grown more than one year in four on the same field to minimized disease and insect outbreaks.
Production is forecast at 20.0 Mt, as the hot, dry weather conditions experienced across key growing regions during the summer is expected to significantly reduce yields and oil content. EU rapeseed supply is forecast to fall by about 7% due to the expected drop in output and reduced imports. The biodiesel industry continues to focus on rapeseed and rapeoil as its main feedstock due to domestic supply and the crop's physical properties.

Domestic crush is forecast to fall marginally to 22.7 Mt while exports decline marginally to 0.1 Mt. EU-27 rapeseed oil consumption is forecast to decline slightly to about 9.5 Mt for 2010-2011 with 6.8 Mt of this for industrial use, a rise of 4% from 2009-2010. EU rapeseed meal consumption is projected to decline slightly to 12.5 Mt.

United States: Seeded Area Rises Sharply

For 2010-2011, a record area of 1.52 million acres was seeded to canola, an 84% increase from the previous year. About 87% of the canola area is centered in North Dakota with Oklahoma becoming the number two producing state as the US attempts to expand its winter canola area in response to attractive returns. The shift into canola is attributed to improved returns for canola and lower wheat prices over the past two years combined with the difficult to control fusarium outbreak in wheat across the Red River Valley. Canola production is forecast to rise by almost 50% from 2009-2010 to a record high of slightly under 1.0 Mt. For 2010-2011, the US is expected to import 0.3 Mt of canola while exports, all to Canada, are expected to exceed 0.3 Mt to Canada to service the recently constructed crush facilities within the rained out regions of Saskatchewan. US imports of Canadian oil are forecast to increase for 2010-2011, making the US both Canada's largest customer for canola oil and the world's largest importer of canola oil.

India: Production Rises

Rapeseed production in India is forecast to rise to 7.0 Mt for 2010-2011, assuming a normal monsoon season. For the year-to-date the overall spread of rain fall has been patchy with some parts of east and central India receiving below-normal moisture. Planting of the fall and early harvested crops is ahead of normal compared to last year. Trade in the rapeseed complex will be limited to importing small volumes of seed and oil with exports of rapeseed meal expected to be unchanged at 0.75 Mt. India is the world's third largest consumer of vegoils and which is expected to reach 17.1 Mt for 2010-2011.

PRICES

On September 29, 2010, canola was quoted at $508/t (in-store Vancouver) versus $424/t a year earlier. The monthly canola oil (crude, in-store Vancouver) was $882/t for July 2010, averaging $860/t for 2009-2010 and $918/t for 2008-2009. Canola meal prices (in-store Vancouver) averaged $222/t for July 2010, slightly below the year to-date average price of $250/t and $275/t for 2008-2009.

For 2010-2011, the price of canola (in-store Vancouver) is forecast to average $460-500/t, up slightly from $424/t in 2009-2010. Canola prices for 2009-2010 declined by 9% from the previous crop year in response to the strengthening Canadian

Source: Intercontinental Exchange

dollar. It averaged a high of $467/t in 2007-08. The 10 year average is $372/t. Prices are expected to be supported by tight supplies and strong world demand for vegetable oils for food and biofuel. The Canadian dollar will continue to play an important role in influencing the price of Canadian canola in 2010-2011.

For 2009-2010, the Canadian dollar averaged US$0.955 per CAN dollar and ranged in value from a low of US$0.903 to a high of US$1.00 per CAN dollar. For 2010 to-date, the dollar strengthened slightly to an average of US$0.967 per CAN dollar and ranged in value from a low of US$0.928 to a high of US$1.00 per CAN dollar.

Canola Crush Margins

The canola crush margin is an indicator of the economic strength of the oilseed processing sector. The Canadian canola crush margin declined slightly in 2009-2010 largely due to lower soyoil and soymeal prices relative to canola compared to the previous year. For 2010 to-date, the crush margin for canola, as calculated by Agriculture and Agri-Food Canada, is $61/t, although it has strengthened in October on support from higher US soyoil and soymeal prices. For 2009-2010, the canola crush margin averaged $71/t compared to $81/t for 2008-2009 and the five year average of $70/t.

MAJOR DEVELOPMENTS IN THE CANADIAN CANOLA SECTOR

Expansion Of The Canadian Oilseed Crush Industry

For 2010-2011, Canada is forecast to crush a record 5.5 Mt of canola, up from the record 4.79 Mt crush in 2009-2010, due to the expansion of crushing capacity. The expected rise in crush is supported by the strong international demand for biodiesel and the growing US demand for healthy edible oils. However, the expansion in crush volumes may be constrained by tight domestic supplies in 2010-2011 as the recently opened James Richardson International, and the joint venture Mitsui-LouisDreyfus Canada facilities in Yorkton, Saskatchewan, along with the neighbouring Bunge plant in Harrowby, Manitoba, are located in the middle of the flooded out area for canola. Supplies of canola are expected to be tight in this region, forcing the plants to originate canola from a larger-than-normal catchment area for 2010-2011. The crushing plants may import canola from the State of North Dakota to meet their seed requirements. If this occurs, Canadian imports of canola could rise to as high as 0.5 Mt.

Trade Issues

The canola industry is facing several challenges in exporting canola and canola products from Canada. Since the spring of 2009, seven oilseed processing facilities were placed on the US Food and Drug Administration's (FDA) Import Alert list because Salmonella was detected in canola meal shipments from these facilities and currently four of the seven facilities remain on the list. The Government of Canada continues to work with the FDA to resolve the issue while undertaking a number of quality control procedures within Canada. The Canadian government has requested that this issue be made a priority issue within the US so it can be resolved as expeditiously as possible.

On October 15, 2009, China's General Administration of Quality Supervision Inpsection and Quarantine (AQSIQ) notified the Canadian Food Inspection Agency that two shipments of Canadian canola had treated positive for blackleg (Leptosphaeria maculans). China also notified Canada that freedom from blackleg would be a necessary condition for importation. As the pest is ubiquitous in Canada, it is virtually impossible for CFIA to certify for blackleg-freedom. As a transitional measure, China agreed to allow canola shipments from Canada into AQSIQ approved crushing facilities in non-rapeseed producting provinces of China. In mid-June, China extended the transitional period for one year under the current restrictions signalling its willingness to explore solutions. The Government of Canada continues to meet with China to negotiate a mutually beneficial solution to this trade dispute. Over the longer term, Canada is sponsoring cooperative studies with China to analyse ways to mitigate the transfer of blackleg to China's crop, look at blackleg presence in Canada to determine a risk reduction strategy and to support feeding trials in Chinese dairy cattle to demonstrate canola meal's ability to increase milk production.

The Canadian canola sector also faced issues from the United States and Europe which could potentially restrict use of the crops as a feedstock for biodiesel. In the US, changes to the Renewable Fuel Standard released by the US Environmental Protection Agency (EPA) in February 2010 effectively blocked Canadian canola from being used as a feedstock for biodiesel. The first change involved the need for lifecycle assessment on crops to ensure that the fuels meet the greenhouse gas reduction thresholds outlined in legislation. This issue has been solved and canola is an approved pathway by the EPA. The second issue requires that feedstocks come only from land already cultivated or cleared prior to December 2007. A process has been developed by the Government of

Canada whereby canola from Canada can meet the same standards as applied to land in the US.

In the EU-27, new directives were issued requiring crops for feedstocks which have a minimum energy savings of 35% in comparison to fossil diesel fuel. This requirement rises to 60% for all new facilities after December 2016. The EU-27 assumes that canola has the same energy savings as rapeseed at 38% allowing canola or biodiesel made from canola to enter the Union until 2018. As the result of differences in production practices between the EU-27 and Canada, Canadian canola is thought to have an energy savings of 60%. The Government of Canada is undertaking several initiatives to position the Canadian industry for beyond 2018.

2011-2012 OUTLOOK

For 2011-2012, the area seeded to canola in Canada is forecast to increase due to high summerfallow area for 2010-2011. Area seeded to canola is expected to exceed 7.0 Mha. Assuming trend yields and normal abandonment, production of canola is forecast to rise by almost 20% although the rebound in supplies will be limited by lower carry-in stocks. The domestic crush is forecast to rise to a record high as the expanded processing sector takes advantage of the higher available supplies of seed. Exports are forecast to rise by almost 10% from 2010-2011 although shipments are expected to be limited by ongoing trade disputes and resistance from price-sensitive importing countries. Carry-out stocks are forecast to rise slightly and prices are forecast to rise slightly from 2010-2011.

Medium Term Outlook

The long run outlook for canola continues to be positive. Rising per capita demand for oils and fats along with rising demand for more protein in the diet and the mandated use of biodiesel is expected to support canola prices. The Canola Council of Canada's is forecasting production of 15 Mt of canola by 2015 as new high-yielding hybrid varieties continue to be adopted by farmers. AAFC's *Medium Term Outlook* for Canadian canola production is to rise to about 14 Mt by 2018. The long-run growth in demand for canola oil and canola meal in countries such as China, Mexico and Pakistan is expected to grow as incomes and populations rise over the next 10 to 20 years. Canada is expected to face competition from the growth in soybean production in South American and from higher palm oil production in Indonesia. However, the production of oilseeds in Russia, Ukraine, Belarus and Kazakhstan is expected to remain relatively stable over the next 10 years as those countries focus on raising cereal output. Canada continues to search for its agronomic limit on canola production and this limit is not expected to be reached in the near future. This should be supportive to farmer incomes and to Canada's canola crushers and exporters. Over the medium term, Canadian exports of seed, oil and meal are expected to contribute to a positive balance of payments and support economic growth for the country.